**FTR Now**

# 2012 Federal Budget – Highlights For Employers

**Date:** March 30, 2012

On March 29, 2012, the federal government tabled its 2012 Budget, Economic Action Plan 2012 – A Plan for Jobs, Growth and Long-Term Prosperity. As widely anticipated, the Budget alters the retirement landscape for many Canadians and announces cost-cutting measures and reform of the federal public service. It also proposes certain tax reform measures, and provides for more direct research and development grants for businesses and various other initiatives aimed at promoting innovation. This *FTR Now* focuses on some of the key proposals that are of particular interest to employers and human resources professionals.

## PENSION AND BENEFITS INITIATIVES

### LONG-TERM DISABILITY PLANS

The government has committed to introducing legislation that will require federally regulated private sector employers to insure, on a go-forward basis, long-term disability plans offered to employees. The proposal furthers the government's March 2010 announcement that it will explore ways to better protect workers affected by employer bankruptcies.

The proposed change will have cost and administrative implications for federal private sector employers that provide long-term disability benefits under administrative service only or other self-funded arrangements.

### GROUP SICKNESS OR ACCIDENT INSURANCE PLANS

Presently, tax does not apply on contributions to or benefits from group sickness or accident insurance plans where benefits are payable on a non-periodic basis or where there is no loss of employment income.

The Budget proposes tax changes in respect of employer contributions made to these types of group sickness or accident insurance plans. Specifically, employees will be subject to tax on the employer contributions made in respect of these benefits, for coverage after 2012, in the year that the contributions are made. This change is to apply to contributions made on or after March 29, 2012, although employer contributions made in 2012 will not be taxable to employees until 2013.

The proposed change will impact employees who participate in group sickness or accident insurance plans (e.g., critical illness insurance) where benefits are payable on a non-periodic basis and/or where there is no loss of employment income. The Budget clarifies that the change will not affect private health services plans (e.g., plans providing benefits for hospital or medical care or expenses). The change is also not expected to impact standard disability plans which provide for periodic benefit payments.

Employers should confirm how these tax changes may affect employee communications and contracts, and if necessary make appropriate modifications to reflect these proposed changes at the earliest opportunity.

### PRIVATE HEALTH SERVICES PLANS

The disability-related expenses eligible for the Medical Expense Tax Credit are to be expanded to include certain expenses (e.g., blood coagulation monitors) incurred by individuals who require anti-coagulation therapy, for expenses incurred after 2011. The proposed changes will mean that these additional qualifying expenses can be recognized under Private Health

Services Plans.

## POOLED REGISTERED PENSION PLANS

On November 17, 2011, the government introduced Bill C-25, *An Act relating to pooled registered pension plans and making related amendments to other Acts* (the "PRPP Act"). The PRPP Act establishes Pooled Registered Pension Plans ("PRPPs") as a new type of occupational-defined contribution pension scheme to be administered by a financial institution, not an employer. PRPPs are meant to provide an accessible, large-scale and low-cost pension option for employers, employees and self-employed individuals.

Shortly after the introduction of the PRPP Act, the government released proposed amendments to the *Income Tax Act* to enable the establishment of PRPPs. The Budget announced that the PRPP tax rules will be implemented sometime in 2012.

Provincial governments still need to enact enabling legislation to allow provincially regulated employers to participate in PRPPs. As reviewed in our *FTR Now,* Ontario Budget 2012, the Ontario government has expressed a number of concerns respecting the federal PRPP model. In contrast, the 2012 Quebec Budget introduced a mandatory retirement scheme based on the PRPP model for all employers with five or more employees. It remains to be seen whether or how Ontario and certain other provinces will choose to make PRPPs available.

For a summary of PRPPs and the PRPP Act, see our *FTR Now*, *Pooled Registered Pension Plan Framework Introduced* of November 23, 2011.

### *PENSION BENEFITS STANDARDS ACT*

The Budget indicates that the government will introduce amendments to strengthen the federal *Pension Benefits Standards Act*, which applies to pension plans for employees of businesses that are subject to federal regulation. No further details are provided in the Budget papers.

## EMPLOYEE PROFIT SHARING PLANS

Employee Profit Sharing Plans ("EPSPs") are a flexible after-tax savings vehicle designed to enable employers to share profits with employees.

As we reported in our *FTR Now,* Federal Budget 2011, the government announced in its 2011 Budget that it would review the existing tax rules for EPSPs to determine whether changes are needed to address the misuse of EPSPs by some business owners. In 2011 the government undertook public consultations in respect of a range of issues.

The Budget proposes a single reform measure aimed at addressing perceived abuses affecting "specified employees"– defined as an employee who has a significant equity interest in his or her employer or who does not deal at arm's length with his or her employer. Specifically, where in a given year an amount allocated under an EPSP to a specified employee exceeds 20% of the salary the employee received from the employer in the year, a special tax will apply. The effect of the special tax is to tax the portion of the allocation in excess of the 20% threshold at the highest marginal tax rate, rather than at the tax rate that would normally apply. The Minister of National Revenue will have the authority to waive or cancel application of the special tax where it is just and equitable to do so.

The special tax on excess EPSP allocations will apply to EPSP contributions made by an employer on or after March 29, 2012. The tax will not apply to pre-scheduled contributions required under a legally binding contract made prior to that date.

Employers – in particular, closely-held companies – that maintain an EPSP should review the terms of their EPSP to ensure that contributions in respect of specified employees do not inadvertently trigger the new tax.

The Budget does not indicate whether any of the other potential changes considered in the 2011 EPSP consultation remain under active consideration.

### RETIREMENT COMPENSATION ARRANGEMENTS

A Retirement Compensation Arrangement ("RCA") is a type of employer-sponsored, funded retirement savings arrangement. RCA contributions together with any income and gains realized on RCA investments are subject to a refundable 50% tax which reduces effective investment return on assets held in RCAs. The RCA tax is generally only refunded when taxable distributions are made from the RCA.

The Budget proposes new RCA rules intended to address certain features that the Canada Revenue Agency ("CRA") has identified as being subject to misuse. Specifically, it proposes prohibited investment and advantage rules aimed at preventing RCAs from engaging in certain non-arm's length transactions. The proposed rules are comparable to rules in place for Registered Retirement Savings Plans, Registered Retirement Income Funds and Tax-Free Savings Accounts.

In addition, the Budget proposes rules to restrict RCA tax refunds where RCA property has lost value and is reasonably attributable to prohibited investments or advantages. However, the Minister of National Revenue is to be provided authority to refund RCA tax if satisfied that it is just and equitable to do so.

The proposed RCA rules, which are to apply to contributions and transactions on or after March 29, 2012, are unlikely to affect most RCAs. However, employers that sponsor RCAs – particularly those with beneficiaries having a significant interest in the employer – should review their RCA arrangements to confirm the potential impact of these proposed changes.

### REGISTERED DISABILITY SAVINGS PLANS ("RDSP")

The Budget announces a series of changes applicable to RDSP flowing out of a review of RDSPs launched in 2011. The changes are designed to improve the flexibility and administration of RDSPs.

## CHANGES TO FEDERAL SOCIAL SECURITY PROGRAMS

### OLD AGE SECURITY AND GUARANTEED INCOME SECURITY BENEFITS

The age for eligibility for Old Age Security ("OAS") and Guaranteed Income Security benefits will be gradually increased from 65 to 67. Implementation will begin in April 2023 and will be fully achieved by January 2029. Those who are 54 years of age or older by March 31, 2012 (born on or before March 31, 1958) will not be affected by this change. Those born between April 1, 1958 and January 31, 1962 will have an age of eligibility between 65 and 67. Those born after February 1, 1962 will have an eligibility age of 67.

Beginning July 1, 2013, eligible Canadians will be able to voluntarily defer taking OAS benefits, for up to five years, resulting in an actuarially adjusted pension and higher annual benefits.

Certain federal programs (e.g., programs provided by Veteran Affairs Canada and Aboriginal Affairs and Northern Development Canada) that currently provide income support benefits until age 65 are to be aligned with the changes to OAS.

Employers sponsoring pension plans that provide bridging benefits should consider the potential impact that these changes may have on related benefits and liabilities.

### EMPLOYMENT INSURANCE PROGRAM

With a view to ensuring stable Employment Insurance ("EI") premiums for employers and workers going forward, the

government has continued the 5 cent limit on EI premium rate increases imposed in 2011 and 2012. The government will introduce legislation to limit the EI premium increase in a given year to no more than 5 cents per $100 of insurable earnings until such time as the EI Operating Account is balanced. Limits will continue to apply once the EI Operating Account has achieved balance. The government will also take steps to ensure that upcoming EI premium changes are announced earlier so that employers and workers have longer notice of pending rate changes.

The Budget also announces investments aimed at encouraging EI claimants to seek work, and providing better labour market information to EI claimants who are searching for employment.

# CHANGES TO THE FEDERAL PUBLIC SERVICE

## FEDERAL WORKFORCE REDUCTION

The Budget provides for planned reduction in departmental spending which will result in a reduction of federal employment by 19,200 jobs, or 4.8% of its workforce. This figure takes into account attrition through retirement or voluntary departures. Approximately 600 executive positions will be eliminated, accounting for 7.4% of the executive workforce.

## PUBLIC SECTOR COMPENSATION

In addition to the general 4.8% reduction in the overall federal public sector workforce, the government intends to continue with measures to align public sector compensation with that of other public and private sector employers by eliminating the accumulation of severance benefits in cases of voluntary severance and retirement.

It also intends to recognize prior years of service of former members of the Canadian Forces who join the public service for the purposes of calculating vacation entitlements, commencing April 1, 2012.

## PUBLIC SERVICE PENSION

Pensions are a significant element of total compensation expense for the government. While the Budget confirms the government’s commitment to respecting its pension obligations, it also confirms the government’s intention to ensure that its pension plans are sustainable, consistent with retirement programs offered in other jurisdictions, and fair relative to programs offered to employees in the private sector. The Budget announces that the government will work with federal Crown corporations to ensure that the pension plans offered to their employees are financially sustainable and aligned with the pension plans provided to public servants. Consultations on the changes outlined in the Budget are expected in the coming months.

Most federal public servants participate in the Public Service Pension Plan. The Budget proposes that this pension plan will be amended to require employees to bear 50% of the contribution costs over time. Similar measures will be applied to the pension plans established for Members of Parliament and for employees of the Canadian Forces and the RCMP. Pension plans for public servants that currently provide for an unreduced pension at age 60 are proposed to be amended to increase the unreduced retirement age to 65 for employees hired into the federal public service starting in 2013. Amendments to the pension plan for Members of Parliament would take effect in the next Parliament.

# MISCELLANEOUS

The Budget also addresses a variety of miscellaneous issues that will be of interest to employers generally or those operating within certain sectors.

**Compensation for Employers of Reservists:** The government intends to provide employers of Reservists with financial support to offset the business costs of employing Reservists, including the hiring and training of replacement workers or

increasing overtime hours for existing employees when part-time Reservists sign up for full-time duty. Further announcements about this new program will be made in the coming months.

**Written Responses to Business/Graduated Penalties for Late Filing:** The Budget proposes a number of initiatives to assist with reducing the tax compliance burden on businesses. Initiatives include having CRA provide written answers to questions through the Business Enquiries service, and graduating or reducing penalties for late filing of T4s and certain other information returns for businesses that are unable to comply in a timely manner with reporting obligations and where the number of late-filed returns is small.

**Wage Earner Protection Program ("WEPP"):** The WEPP, introduced in 2008, facilitates the payment of worker claims for unpaid wages, vacation pay, severance and termination pay, subject to certain limits. The Budget earmarks $1.4 million annually, for the purpose of expediting the processing of WEPP claims.

**First Nations Education:** Following on initiatives announced in Budget 2010, the government and the Assembly of First Nations launched a National Panel in 2011, which tabled recommendations for reforming First Nations education. In this Budget, the government has announced that it will work with willing partners to introduce a First Nation Education Act, to be in place by September 2014. Through the establishment of structures and standards, the legislation is intended to promote strong and accountable education systems on reserve.

**Temporary Foreign Workers:** The government will strive to better align the Temporary Foreign Worker Program with labour market demands, and to ensure that employers have made all reasonable efforts to recruit within the domestic labour force prior to accessing the Program. To that end, the government will create a link between the Program and the EI regime, whereby EI claimants would be notified when employers are seeking to recruit new workers, and employers would be notified of local, qualified EI claimants.

## CONCLUSION

We will continue to monitor the Budget initiatives and keep you informed of program details as they emerge and the introduction of implementation legislation.

If you have any questions regarding Budget 2012, please contact your regular Hicks Morley lawyer.

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